

**BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

**In the Matter of**

**Milk In The Central**

**Marketing Area**

**:**

**: Docket Nos.:**

**: AO-313-A44 et al;**

**: DA-01-07**

**:**

**BRIEF FOR DAIRY FARMERS OF AMERICA,  
PRAIRIE FARMS DAIRY, INC. AND  
SWISS VALLEY FARMS COOPERATIVE**

**Date: January 7, 2002**

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## **I. INTRODUCTION**

This brief is submitted by DFA, Swiss Valley, and Prairie Farms in accordance with the briefing schedule established at the close of the hearing. It addresses all proposals at the hearing, those advanced by these proponents and those proposals advanced by other parties. The hearing proposals primarily concern pooling issues, as well as an important producer payment issue.

The dysfunction of Order 32 as presently structured was epitomized by the testimony of Gary Lee for Prairie Farms who described how on September 15, 2001, Prairie Farms had to shut down its pool distributing plant in Carlinville, Illinois, and delay production of Class I products for nearly a full day because milk was not available to the plant. (TR. 335) This was in a month when 1.4 billion pounds of milk were pooled on the order with Class I utilization of only 28.2%, while Class III utilization exceeded 59% and 56% of pooled milk was diverted to nonpool plants for the production of Class III products. (Exh. 5, Tables 4 and 6)

It is imperative that the Secretary address these disorderly conditions.

## **II. FACTUAL BACKGROUND**

### **Proponents**

1. Dairy Farmers of America, Inc., (DFA) is a Capper-Volstead cooperative association of 16,905 dairy farms producing milk in forty-six (46) states. DFA regularly markets milk on 10 of the 11 federal milk orders, including Order 32. DFA's Central area Council consists of some 5500 member farms primarily in the marketing area for Order 32. (TR. 141; Exh.. 8, p.1)

2. Swiss Valley Farms Cooperative (Swiss Valley) is a Capper-Volstead cooperative association of more than 1500 members. Swiss Valley markets milk in 4 of the 11 federal orders

from farms located in Minnesota, Iowa, Wisconsin, and Illinois. It owns and operates an Order 32 pool distributing plant at Dubuque, Iowa, and has order 32 pool supply plants as well as nonpool plants which receive milk pooled on Order 32. (Tr. 142; Exh. 8, p.1)

3. Prairie Farms Dairy, Inc., is a Capper-Volstead cooperative owned by 800 dairy farmer members. Prairie Farms owns and operates 7 milk processing plants located in Order 32 and pooled under the order. In addition, Prairie Farms is the operating partner for 7 other Order 32 distributing plants. (Tr. 142; Exh.8, p.1) Prairie Farms owns or operates in joint ventures 14 pool plants in Order 32 and 6 unregulated plants in the marketing area. (Exh. 15, p. 1)

### **The Market**

4. Federal Order 32, the order regulating handling of milk in the Central marketing area, effective January 1, 2000, is a product of the consolidation of the following former orders: Iowa, Order 79; Southern Illinois-Eastern Missouri, Order 32; Central Illinois Order 50; Nebraska Western Iowa, Order 65; Eastern South Dakota, Order 76; Kansas City, Order 64; Southwest Plains, Order 106; Eastern Colorado, Order 1137; and Western Colorado, Order 1134. (TR. 152-153; Exh. 8, pp.7-8)

5. The order stretches more than 600 miles from North to South and more than 1200 miles from East to West. Most of the area of the order south and west of Iowa consists of a number of large metropolitan areas, including St. Louis, Kansas City, Denver, Wichita, and Oklahoma City, with only modest concentrations of milk production nearby. Milk production in the area is most concentrated in northern areas. (Exh. 7) However, the areas of greatest population, including the 4 metropolitan areas of 1 million or more, are to the south and west. (Exh. 8, p. 10)

6. Order 32 was developed in the federal order reform process by application of a set of market definition principles set out in the final decision. See 64 Fed. Reg. 16045 (April 2, 1999). (TR. 160–170 ; Exh. 8, pp. 14–20) Those principles included the concept that milk should perform for the market in order to qualify for pooling. “Open” pooling was specifically rejected as a basis for associating milk with federal order pools. (TR. 172; Exh. 8, p. 22)

7. The former Iowa order and areas to the east and south was not included in the consolidated Upper Midwest Order in federal order reform on the basis of handlers greater association with markets to the south and east. (TR. 163–164; Exh. 8, p. 17)

8. Order 32 combined orders in which the handlers had substantially overlapping distribution routes and the producer supply was extensively commingled. The Final Decision reported that more than three-quarters of the milk for the consolidated Central Order came from within the marketing area. In September 2000 and September 2001, less than 55% of poolings was from the marketing area. (TR. 158–160 ; Exh. 8, pp. 12–13; 64 Fed. Reg. at 16072; Exh. 5, Table 12)

9. The combined Class I utilization of the Central order was estimated to be about 50 percent. (TR. 159–160 ; Exh. 8, pp. 12–13)

10. The actual Class I utilization on Order 32 has averaged less than 30 percent and was 25.4% for the first 9 months of 2001. (Exh. 5, Table 2.)

11. The reduced Class I utilization has resulted from the pooling of large numbers of producers and milk volumes from sources outside the marketing area, in particular producers from the states of Minnesota, Wisconsin and California. (Exh. 7; Exh. 5, Tables 11–14)

12. The pooling of milk from areas not previously associated with the marketing area has resulted in a reduction in the blend price. Estimates provided by Mr. Hollon for selected months recorded decreases in the magnitude of \$.44–1.17 per hundredweight. (Exh. 9, Tables 16–17) This reduced blend price has made pooling on Order 32 less competitive with alternatives to the south and east, Orders 5 and 7. (Exh. 16, Tables 3--4; Exh. 9, Tables 5--6) It has also reduced the difference between the Order 30 blend to the north and the Order 32 blend, thereby reducing the return from performing for the Order 32 market. (Exh. 9, Table 7; Exh. 16, Table 2) The reduced blend price materially impairs the ability of Order 32 plants to attract milk supplies for the fluid market, as the experience of Prairie Farms, Suiza Foods and Mid-States Dairy has demonstrated. (TR. 318–353; 532–535; 383–390)

13. The pooling of milk from outside the marketing area has been facilitated by pooling provisions which allow, through various mechanisms, milk to be pooled on the order with the requirement of few if any deliveries to distributing plants serving the marketing area. Among the provisions which accommodate the association of milk from distant locations without performance are: (1) the provisions which allow pyramiding of shipments to distributing plants for pooling purposes, allowing a 1 to 16 delivery-to-pooling ratio; (2) provisions which allow distant supply plants to be qualified by delivery of milk from nearby, in-area producers; (3) the provisions allowing use of shipments to other order distributing plants to serve as qualifying shipments for Order 32; and (4) the provisions which allow a “free ride” to supply plants during certain months of the year.

14. The partial payment provisions of Order 32, utilizing the prior month’s lowest class price, have resulted in a reduced payment to producers on the check for initial partial payment for

monthly milk deliveries. The rate of payment has been reduced on average by \$.50 or more per hundredweight. (TR. 564-577; Exh. 24-25)

15. In spite of the low utilization on the order, distributing plant operators in the largest metropolitan area of the market, St. Louis, have had difficulty attracting milk supplies from Order 32 sources, even with substantial premium prices prevailing. Furthermore, in several parts of the marketing area, including southern Illinois, eastern Missouri, and western Colorado, production has declined or migrated to supply other markets. (TR. 318-335; Exh. 16, Table 1; TR. 394) At the same time, the order 32 blend price and performance requirements are insufficient to attract additional supplies from order 30 to supply order 32 distributing plants. (TR. 318-335; Exh. 16, Table 2)

### **III. THE DISORDERLY MARKETING CONDITIONS IN ORDER 32**

There are at least three ways in which the current Order 32 pooling provisions are creating or accommodating disorderly marketing at present. First, there has been a substantial diminution in the blend price returned to producers regularly supplying the market. Second, distributing plants which were well-served prior to consolidation have experienced difficulty in attracting supplies post-consolidation. Third, equity among producers has been eroded by virtue of large numbers of producers becoming associated with the order without demonstrating and providing any material performance to the order. Each of these factors, individually, as well as taken together, demonstrates the urgent need to amend the pooling provisions of the order and we will discuss each factor in turn.

1. Blend price reduction. This order was formed with the expectation that it would have a Class I utilization of about 50%. Instead, it has had a utilization of less than 30%, averaging

only 25% in 2001. This has meant financial stress on local farms as the producers testified. (Siebenborn, TR. 367–373; Bond, TR. 109–113; Defrain, TR. 116–121) The reduction in the blend price has also made the order’s distributing plants less competitive for milk supplies with higher utilization orders to the south and east. (Lee, TR 329–330 Exh. 16, Tables 2–4; Yates, TR. 383–390; Hollon, TR. 177-78; Exh. 9, Tables 5–7; Siebenborn, TR. 371) The result has been an erosion in supplies available to Order 32 distributing plants from traditional areas of supply and a reduction in production in some areas of the milkshed. Areas of the milkshed in which this has occurred include souther Illinois, eastern Missouri, and western Colorado. Both Mr. Hollon for DFA, and Mr. Lee for Prairie Farms demonstrated the procurement disadvantage for order 32 plants under current pooling practices. (Exh. 16, Tables 2–4; Exh. 9, Tables 5–7)

2. Supplies for distributing plants. There is undisputed testimony in the hearing record that St. Louis area plants have been having difficulty attracting a supply of milk for their needs under current Order 32 pooling provisions. Three plant operators testified with the same basic theme. Gary Lee for Prairie Farms described the difficulties which Prairie Farms has had attracting milk for their facilities. (TR. 322–335; Exh. 16) Incredibly, there have been occasions when they had to cease operations at distributing plants for lack of milk. (TR. 335) This is certainly clear evidence of a dysfunction in the order’s regulations. If providing an adequate supply for the Class I market means anything, it should mean that the pooling provisions make it possible for distributing plants in the largest metropolitan area of the order to be provided with a supply of milk to maintain ordinary operations of such plant facilities. It should be emphasized that over order prices are not at issue since all distributing plant operators indicated a willingness and the necessity to pay substantial over order prices. The problem is that the diluted order 32

blend price is insufficient to attract supplies of milk (which are committed to manufacturing uses)<sup>1</sup> to order 32 Class I plants.

Prairie Farms' experience in the summer and fall of 2001 presents stark testimony to the malfunction of order 32 as presently structured. Mr. Lee testified: "In August and September [of 2001] there were many days when we had to wait for several hours at a couple of our plants for milk to arrive, and so we had to run water through the machines to keep them going. It reached a peak on September 15 when, at our plant in Carlinville, we had to send all of the plant workers home at 2 in the afternoon and tell them not to come back till midnight because we had no milk to run. . . ." (TR. 334-335) This was in spite of the fact that Prairie Farms was paying spot market premiums of \$2.50 or more per hundredweight in excess of prevailing premiums which already exceeded \$1.00 per hundredweight for Class I supplies. (Exh. 16, Table 5)

Prairie Farms is not alone. Both Suiza Foods (Yates, TR. 386-87) and Midstates (Mueller, TR. 532-535) testified to similar difficulties in the St. Louis area. While these plants have been having trouble attracting milk supplies, pooled milk was qualifying on the basis of its delivery to "other order" plants, notably Order 30 pool plants<sup>2</sup>. See Exh. 5, Table 16A. These are not shipments which are beneficial to the order by increasing the Class I usage. They are shipments which facilitate the non-performing pooling, at a 16 to 1 ratio, of Order 30 area milk

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<sup>1</sup> The witness for Foremost Farms testified as follows when asked why they did not make milk available to Prairie Farms when it was needed in September 2001: "[T]he demand for Class III or Class IV, in our instance, Class III was high, ...we had some obligations to cheese customers for Class III milk. And, therefore, and as long as we were exceeding the shipping requirements, and we took care of that [Class III] obligation first." )TR. 449, ll. 1-8)

<sup>2</sup> Since January 2000, over 3/4 of the shipments to other order plants have been to Order 30 plants. (Exh. 5, Table 16A)



This is a certainly a textbook example of disorderly marketing conditions.

3. Pooling without performance. Equity among producers in a milk order requires a minimum level of shared performance in meeting the market's Class I needs, thereby contributing to the revenue which is distributed through the market order pool in the form of the blend price. The record demonstrates, however, that Order 32 presently allows mechanisms for producers to be "associated" with the order, drawing the blend price, without performing in any substantial way to meet the order's needs. This is documented by the large volumes of milk being pooled from geographic locations which are inherently uneconomic sources of supply to any Class I plants in the market.(Exh. 9, Tables 11-15) The Market Administrator's records show the location of milk supplies presently pooled on Order 32, including large supplies in the areas of Minnesota and Wisconsin, north of any historical supplies for the market (Exh. 7); and milk from the states of California, Idaho, and North Dakota. (Exhs. 5, 7 and 8) Mr. Hollon demonstrated, and it is not seriously contested, that these milk supplies cannot economically serve the market by actual deliveries of any substantial quantity. (Exh. 9, Tables 11-15) The current provisions simply allow one-day delivery association and pooling-by-proxy in the form of being "covered" by a handler's other milk being delivered to the market. It is uncontroverted in the record that the distant milk is not serving the market; it is simply being pooled and drawing the blend price, to the detriment of those producers actually serving the market.

The argument that is made by some, including the witness for Land O'Lakes, that this milk is actually performing is hollow and begs the point, which is: How can such "performance" be considered meaningful in meeting the needs of Order 32 when the milk does not move and cannot economically move on any regular basis? Furthermore, how is it equitable that regular

suppliers to the market share the blend values generated by their deliveries with producers who do not and cannot economically serve the market? The need to reexamine the minimum requirements for pooling on order 32 cries out from the hearing record and mandates adoption of the several proposals advanced by these proponents.

#### **IV. PROPOSED AMENDMENTS 1—5**

Proposed amendments 1 through 5, advanced and supported by these proponents and other parties at the hearing, are intended to address and cure the disorderly conditions in the order created by the current pooling provisions. The amendments address a number of specific defects in the present order provisions and, more generally, reform the present pooling provisions to require performance with the market which is more in line with the market's needs and conditions in the marketing area. We will address the proposals in turn:

A. The requirements for Order 32 pool supply plants should be amended as requested in Proposal 1.

Proposal 1 amends the supply plant provisions of Order 32, 7 CFR § 1032.7(c) in each of the following respects, which will be discussed in turn:

- (1) It eliminates the “free ride” periods for supply plants;
- (2) It limits use of in-area milk to qualify supply plants outside of the marketing area;
- (3) It eliminates shipments to other order plants as qualifying shipments for Order 32 purposes;
- (4) It revises the percentages of deliveries required to be shipped to qualify a supply plant; and
- (5) It allows shipments to any plant in an Order 32 distributing plant unit to serve as a

qualifying shipments for order 32.

Elimination of the “free ride” period. The order presently provides (1032.7(c)(2)) automatic pooling, without any qualifying shipments required, during the months of May, June, and July. There is no justification under present marketing conditions for this so-called “free ride” period. All milk, plants and producers, associated with Order 32 should be required to serve the market on a year round basis. There was little, if any, testimony in opposition to this change in provisions. The primary spokesman for the group of upper midwest opponents took no position on the elimination of the free ride.

Eliminating qualification of out-of-area supply plants with in-area milk. Proposal 1 eliminates the use of local, in-area milk deliveries to qualify out-of-area supply plants. The present order language allows shipments to be made from any location and have those shipments used as qualifying shipments for a distant supply plant. For instance, a cooperative with producers in central Iowa could deliver to a local Iowa distributing plant and have such deliveries serve as the required shipments from a supply plant in central Minnesota or Wisconsin. Since the record demonstrates that deliveries from the distant Minnesota or Wisconsin areas are not economic (if deliveries are actually made) this provision in the order allows qualification of milk which cannot economically serve the market to be made strictly “on paper” and not by delivery of that distant milk, whether directly or from a plant. This provision in the order is certainly one of the major loopholes which allows association of distant milk without performance and it should be eliminated.

Elimination of qualification credit for shipments to other order plants. There is no justification under present marketing conditions for shipments to other order plants to be used to

qualify order 32 distributing plants, even with the 50% limitation. The record shows that in some months all shipments to other order plants were to Order 30, demonstrating that milk which is part of the actual supply for that order is being pooled of order 32. While it is true that the Class I utilization comes onto order 32 with such shipments, that is not a sufficient justification for maintaining this provision which is not justified and being abused. The record clearly documents that in the same time periods that order 32 distributing plants were begging for milk, milk was being qualified for pooling on order 32 by deliveries to other orders, including order 30 plants. (Exh. 16A)

The months and percentages of required delivery should be revised. Proposal 1 changes the required deliveries from pool supply plants to: 25% of receipts in August through November, and 20% in all other months. The revised language makes these percentages “real” percentages which increase required performance although the stated percentages are nominally less than the 35% presently stated in the order for performance months. The performance must be made from the supply plant’s total supply of milk, including diverted milk. These percentages, along with the changes in the producer milk definitions discussed below, establish a 1 in 4 and 1 in 5 qualification equation to supercede the current 1 in 16 ratio which the order language allows.

The 20/25% level of performance is quite justified on the record. Order 32 is a large geographic marketing area of substantial Class I demand. It is third in rank among federal orders on the basis of gross class I utilization (Exh. 9, Table 1) and the usage is at plants in 7 states. This level of performance is less than the higher utilization orders to the south and east, Orders 5 and 7, and greater than the manufacturing region of order 30 to the north. It is an appropriate intermediate level for this marketing order area.

The objections of the witnesses for the upper midwest cooperatives to the increases in the pooling requirements are, when boiled down, nothing more than requests to continue to “ride” this pool with dedicated volumes of manufacturing use milk, at the same rate, without being obligated to make any more needed and regular deliveries for Class I. AMPI and Foremost are apparently serving the market at the rate of about 12 to 15%, according to the estimates of Mr. Kurth and Mr. Gulden. (TR. 444 (Kurth); TR. 500 (Gulden)) That is plainly and simply inadequate in a market which was expected to have a utilization of 50% and, even under the present unacceptable conditions is at 25%. There was no justification offered by any witness for this group as to why milk in central and northern Wisconsin and Minnesota, as well as other states, which cannot be economically delivered to this market on a regular basis should dilute the blend price for the producers who are actually serving the market. These milk supplies are being delivered, in many cases, to the non-pool side of order 30 pool supply plants, as Mr. Gulden described. (TR. 495–496) That milk is situated to serve order 30 and should be pooled on that order.<sup>3</sup> If these cooperatives want to serve order 32, there is clearly ample opportunity to do so and to be pooled. The modest ratio of 25% required by proposals 1 to 5 is an appropriate and justified level of performance for this market.

The months for highest performance are appropriately revised to include August and eliminate January for the 25% level.

Shipments to Order 32 distributing plant units should be qualifying shipments. Proposal

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<sup>3</sup> Order 30 pool plants, to which order 32 milk is delivered to the “split” side include Jim Falls, Wisconsin; Paynesville, Minnesota; and Blair, Wisconsin. (Gulden, TR. 495-96). The economics of delivering milk from those locations to Order 32 distributing plants is analyzed in Exh. 9, Tables 12–15.

I would amend the order to include deliveries to order 32 distributing plant units as qualifying deliveries. Such units are, in essence, qualified distributing plants under more than one roof and should not be treated any differently than distributing plants under the same roof. The objections of Suiza and Anderson-Erickson that there is some element of discrimination involved with such treatment are unfounded. The current order language actually discriminates against the operator of a distributing plant unit by not allowing qualification on shipments to all parts of that unit. These units must meet, in aggregate, the same tests for utilization as combined Class I/II pool plants. Prairie Farms unit has total Class I utilization of 70 to 75% (Lee, TR. 345), certainly within the range of pool distributing plants. The possibility of depooling a class II plant in a unit during months of price inversions or distortions is not an issue which should blacklist these pool distributing plant units from attracting milk from supply plants.

B. Proposals 2 and 4 should be adopted: The cooperative supply plant provision in Section 1032.7(d) of the order should be eliminated and section 1032.7(g) revised accordingly.

The order presently provides for a cooperative supply plant in Section 1032.7(d) of the order. That provision should be eliminated. No cooperative association is presently using the cooperative supply plant provision of the order. It could, however, if used, enable a cooperative association to “paper” pool milk in ways which would be disorderly. To avoid any future such possibilities, and to be consistent with the other provisions of the order as proposed to be amended, these proponent cooperatives request that this section of the order be deleted. There was no opposition at the hearing to deleting the cooperative supply plant provision. Proposal 2 should therefore be adopted. With the elimination of the cooperative pool plant provision, the

reference to it in section 1032.7(g) of the order should be eliminated in accordance with proposal 4.

C. The performance requirements for supply plant units should be revised as proposed in Proposal 3.

Order 32 provides for the establishment of systems of supply plants which can, in turn, operate subject to the same requirements as a single supply plant. This provides for the possibility that a handler could associate a distant supply plant with the order and not ship any milk from that plant, covering the volume with milk delivered from other plants in the unit. We recognize the efficiency in such a system, which is positive. Proposal 3 advances the modest requirement that units be required to perform at an incrementally higher level than single plants so that the market receives some of the benefit, in the form of additional deliveries, for the efficiency granted to the unit handler. Higher requirements for shipments from units of supply plants has historically been found in pre-reform Order 30 where units were required to ship at the rate of twice the percentage required of single plants. Proposal 3 does not go that far, merely requiring an increase of 20% to 23% in the months of December to July, and from 25% to 30% in the fall months of August to November. These are minimal additional requirements which will help to make the performance requirements of the order more equitable and market-oriented.

D. The producer milk provisions of the order should be revised as set forth in Proposal 5.

There are several aspects of the producer milk provisions of Order 32 which presently allow “paper” pooling of milk on the order without substantial performance. These provisions should be amended as proposed in proposal 5. The primary issues here are (1) to craft the

language so that “pyramid” pooling is not authorized; and (2) to coordinate the diversion limits with the performance (shipping) requirements for pool supply plants. The order presently allows producer milk to be pooled on Section 9(c) reports without ever touching a pool distributing plant as Mr. Stuckenberg confirmed. (TR. 53)

Pyramid pooling must be eliminated. The present language of order 32 has been interpreted and applied by the market administrator (in accordance with its history under order 79) so that the nominal diversion limitations of 65% and 75% (and the nominal supply plant shipping requirements of 35% and 25%) do not really mean that those levels of performance were required. Rather, the diversions can be “pyramided” on the supply plant shipping percentages so that only 25% of 25% of the milk is required to be shipped to pool distributing plants. Mr. Hollon demonstrated this pooling system on Exhibit 9, Table 18; and Mr. Stuckenberg confirmed the manner of its operation in the order. (TR. 66-67) Mr. Kurth also acknowledged its use and history in predecessor Order 79. (TR. 428-429) Proposal 5 makes clear that this artifice will no longer be allowed in the order, while the nominal diversion limitations are increased to 75% and 80% in the various months.

E. Net shipments language should be added to the order to mandate that qualifying shipments are of “net” benefit to the market and to eliminate the potential of “pay to pool” arrangements.<sup>4</sup>

Order 32 should be amended to require that qualifying shipments to distributing plants be measured on a “net” shipments basis. As Mr. Hollon testified, net shipments language assures that shipments to distributing plants involve deliveries of milk which are actually used in meeting

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<sup>4</sup> This provision is supported by DFA and Prairie Farms.



the market's needs for milk at distributing plants and not made solely for the purpose of qualifying milk for pooling without the handler actually giving up use of the milk. Mr. Kurth of Foremost Farms supported net shipments language being added to the order. (TR. 433). Such arrangements involve the pumping-in and pumping-out of milk at a distributing plant solely for purposes of qualification.<sup>5</sup> The milk volumes are not used at the distributing plant, but returned to the qualifying handler for manufacturing use. The end result is milk is pooled without providing service to the market and uneconomic deliveries and milk movements are allowed, if not fostered, by the order regulations.

The net shipments requirement should apply to deliveries both from supply plants and directly from producers. The proposed language<sup>6</sup>, offered as a modification to the hearing notice, was detailed by Mr. Hollon (TR. 246): It would amend Section 1032.7(c) by adding a new subsection (c)(5) to provide: "Shipments used in determining qualifying percentages shall be transferred or diverted and physically received by distributing pool plants less any transfers or diversions of bulk fluid milk products from such distributing pool plants." Also, the producer milk provisions of the order should provide: "Shipments used in determining qualifying percentages shall be milk transferred or diverted and physically received by plants described in sections 1032.7(a), (b), or (e) less any transfers or diversions of bulk fluid milk products from

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<sup>5</sup> These are a species of the "pay to pool" scenario described by Mr. Gulden of AMPI. (TR. 505-06). Obviously if milk is delivered to a plant and then returned to the delivering handler by the plant, the plant is not buying any milk for its use, only providing a "service" to the shipper which allows the shippers milk to be pooled. In a market economy, there will be a cost and payment for this service.

<sup>6</sup> The proposed language is at page 246 of the transcript and involves modifications to both section 1032.7(c)(supply plants) and 1032.13(d)(producer milk).

such distributing pool plants.”

Such net shipment and net receipts provisions are common to many orders and necessary, in proponents’ view, to maintain the integrity of the qualification and pooling requirements.

**IV. PROPOSAL 6 TO AMEND THE PARTIAL PAYMENT REQUIREMENTS OF THE ORDER SHOULD BE ADOPTED**

The payment provisions for Order 32 presently provide that partial payment be made to producers for their milk deliveries during the first fifteen (15) days of the month at a rate equal to the lowest class price for the prior month. Experience since January 1, 2000 under the class prices now prevailing demonstrates that that rate results in a payment to dairy farmers which is lower than it has been historically and it should therefore be increased appropriately. The change in Class 3 and 4 prices under federal order reform, coupled with the use of the “higher of” for the Class I mover has led to an increasing spread between the “effective” blend price and the lowest class price. There is nothing in the federal order reform final decision to suggest that this was intended; and there has been no argument advanced to support a reduction. Consequently, the order should be changed to increase the rate of payment required of handlers pursuant to 7 C.F.R. § 1032.73. These proponents support revision of the rate of payment to require payment at the rate of 105percent of the prior month’s lowest class price.

Exh. 25 demonstrates the erosion of the effective rate of partial payments to producers under Order 32 since January 2000. For the period from January 1997 through August 2001, fifty-six (56) months, the monthly average spread between the Class 3 price and the blend price was \$1.59. However, for the first thirty-six (36) months it was \$1.52 and for the last twenty (20) months it was \$1.71. Producers should not be required to absorb this reduction in cash flow

which is a by-product of the class pricing changes implemented in federal order reform.

These cooperatives propose that the partial payment should be required to be made at the rate of 105percent of the lowest class price as a reasonable adjustment which comes close to approximating the spread that existed over the thirty-six (36) months prior to order reform. This advance payment formula is similar to that present in other orders. (Exh. 25, Table 6) This partial payment level should present no difficulty, in terms of cash flow, to any handlers as it is merely a return to the pre-reform payment rate. Furthermore, for cheese manufacturers, the funds made available for payment to producers are provided through the marketing order pool and it is essentially a pass-through item for them.

The objections of Leprino Cheese Company also do not merit rejection of the proposal. Leprino expressed concern with uniformity from order to order, perhaps not focusing on the fact that some of its competitors are already required to make partial payments at rates higher than proposed by the cooperatives here. Furthermore, Leprino's concern that a manufacturer might have to anticipate funds that it will be receiving from the pool, in order to make the advance payment, may be true (with or without the requested amendments) but should be viewed as part of the bargain that a manufacturing use handler has for the right to participate in the pool which allows it to have the benefit of marketwide pooling of use values in its procurement of milk for manufacturing uses.

Proposal 6 should be adopted to restore to dairy farmers a rate of partial payment for their monthly milk deliveries which is close to that which was applicable pre-federal order reform.

**V. POOLING OF DISTANT MILK, INCLUDING MILK FROM CALIFORNIA,  
SHOULD BE REGULATED BY ADOPTION OF PROPOSAL 7 AND REJECTION OF  
PROPOSAL 8.<sup>7</sup>**

The pooling of milk from California (as well as from other distant, non-historical sources) is a result of pricing dynamics created by federal order reform which established a price grid for location prices for milk which does not depend directly upon the distance which the milk is from the Class I markets of the order involved. Prior to federal order reform, the provisions of Order 32 and its predecessors provided that milk which was pooled under the order but delivered to locations outside the marketing area would be priced in a manner which reflected its diminished value to the pool because of the distance from Class 1 markets. Federal order reform eliminated that pricing system and established a single national grid of location values. 7 C.F.R. §1000.52. This change has made it economical for handlers to associate large volumes of distant milk from California and other areas without any appropriate price concessions to accurately discount the milk's lack of availability to marketing area distributing plants.

The solution to the issue should be the adoption of reasonable requirements of performance by milk from locations outside the established procurement area of the market. Proposal 7<sup>8</sup> would accomplish this by requiring milk produced on distant farms — those outside

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<sup>7</sup> This portion of this brief is supported by DFA and Prairie Farms. Swiss Valley has a separate position on Proposal 8.

<sup>8</sup> Proposal 7 was endorsed at the hearing by the witness for Suiza Foods. (Yates, TR. 406-07) Suiza's position, along with its support of Proposal 8 (TR. 549), indicates that these proposals are not mutually exclusive and a case could be made for adoption of both. DFA believes that adoption of Proposal 7 alone is the best way to address the problems; however, it

the states of the marketing area and beyond the historical procurement regions in Minnesota and Wisconsin — to be grouped by individual state units and perform on the basis of such individual state units. The areas defined in the proposal<sup>9</sup> (see Exh.11, pp. 5-6; Exhs.13-14) are carefully drawn from the historical information provided by the Market Administrator. (Exh.12) The purpose and effect is merely to require milk from distant sources to perform on the same basis, in aggregate, as milk from historical areas of supply for the market. This solution does not discriminate; does not penalize; and does not establish any barriers to pooling of milk from any area in Order 32. It merely establishes a level playing field on which all participants have the same responsibility to serve the fluid market from which they are sharing the revenues.

Proposal 7's distinguishing between “in area” and “out of area” or historical and non-historical sources of milk, and the pooling standards applicable to each, is neither novel for Order 32 nor for the federal order system more generally. Indeed, the proposed amendment mimics, for instance, the criteria for supply plants in Order 30, presently and historically.<sup>10</sup> Also, Order 1

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recognizes that adoption of Proposal 8, in addition, would make a statement that double-pooling should not be allowable.

<sup>9</sup> Proposal 7, as written, requires reporting and performance on the basis of state units. An argument could be made that historical, institutional, and geographical marketing patterns suggest that the “outside” counties in the states of Minnesota and Wisconsin should be grouped together for this purpose. If the Secretary should find that the record supports that grouping for Proposal 7, DFA would not object.

<sup>10</sup> Order 30 presently has two (2) pooling mechanisms for supply plants: First, § 1030.7(c), the basic supply plant qualification provision, requires supply plants to deliver not less than 10% of the grade A milk received from dairy farmers each month to Class 1 plants. Secondly, supply plants may also qualify as a unit of plants pursuant to §1030.7(f). However, the unit system of qualification, which does not require minimum monthly shipments from each plant, mandates that each plant be “located within the marketing area.” It goes on to underscore the required linkage between the location of the plant and its means of qualification by stipulating that: “Cooperative associations may not use shipments pursuant to § 1000.9(c) to

(and Order 2, one of its predecessors, as well as other orders<sup>11</sup>) has had in area and out of area geographical pooling performance units. These distinctions are both justified and legal.

A review of the provisions in other orders demonstrates that orders have addressed in-area versus out-of-area supply issues for many years. The existing language in Order 30 was a continuation of longstanding distinctions in orders 68 and 30. When Order 68 was first established as the Upper Midwest Order, a merger of four prior orders effective in 1976, new definitions for supply plant and reserve supply plants were established. Those definitions distinguished between performance required of plants located in the marketing area and plants located outside the marketing area. Plants located outside the marketing area were required to perform on a monthly basis; plants within the marketing area had the option to elect reserve supply plant status and be obligated to deliver milk only when called upon. When establishing the reserve supply plant system, the Secretary specifically refused to authorize reserve supply plant status for plants outside the marketing area, finding that there was no reason to believe that such plants would in actuality be the source of milk for the market's reserve needs. See 41 Fed Reg. 12436-12479 (March 25, 1976)(Final Decision). Likewise, in the Chicago Regional Order 30, the pool plant language distinguished between in area and out of area supply plants for many years. Similar to Order 68, Order 30 prohibited the association of out of area supply plants in a unit of plants which could perform (by making required deliveries to distributing plants) on an aggregate basis without shipments from each individual plant in the unit. Out of area supply plants were, nevertheless, always eligible for pooling on a monthly performance basis. These

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qualify plants located outside the marketing area.”

<sup>11</sup> See footnote, *infra*.

distinctions existed in Order 30 since at least 1977. See 42 Fed. Reg. 37388 (July 21, 1977)(Final Decision)

In other orders, distinctions between in area and out of area plants have been present for even longer periods of time. In Order 2, the former New York- New Jersey marketing order, “regular pool plants” had to be “located in New York, New Jersey, or Pennsylvania.” since prior to 1960. See 7 C.F.R. § 1002.24(a)(2)(1999) Plants not meeting the geographic criteria could nevertheless qualify as “temporary pool plants” under Order 2 provided they met other standards which involved monthly association with the fluid milk needs of the market. See 7 C.F.R. §1004.28(1999). In the post-reform Order 1, which now regulates the marketing of milk in Northeastern United States, the successor to Orders 1, 2 and 4, the requirement that out of area milk sources associate with the market on a monthly basis in order to be pooled was set out in 7 C.F.R. §1001.13(b). Those provisions simply require that producers outside the states in the marketing area (as well as the states of Maine and West Virginia which have been traditional procurement areas for the Northeastern markets) deliver the same monthly percentage of their production to pool distributing plants as is required of in area plants.<sup>12</sup>

The Iowa Order 79, a predecessor of Order 32, had a longstanding difference in performance required of supply plants depending on their location. See 7 CFR § 1079.7 (1999) (performance varies by location of supply plant).

The common denominator in all of these prior federal order provisions with respect to in

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<sup>12</sup> We have not made an exhaustive study of similar provisions in other pre and post reform orders, but are aware of these: 7 CFR § 1007.7(1999)(provisions applicable only to supply plants within the marketing area); 7 CFR § 1005.7(1999)(c)(cooperative balancing plant must be located in the states of North Carolina, South Carolina, or Virginia); 7 CFR § 1040.7(1999)(b)(3)(cooperative plant located in the State of Michigan).

area and out of area plants or producers is this: Distant plants or producers may qualify and be pooled in a federal order market if that plant, or the producers, on their own, perform in accordance with the minimum performance standards of the order. There is nothing in the application of any such standards which creates in any way, shape, or form a trade barrier to the movement of milk such as is prohibited by 7 U.S.C. § 608c(5)(G).

DFA believes that Proposal 8, which would disqualify from pooling milk identified as participating in a state marketing order pool, will not solve the problems of distant pooling in Order 32 or elsewhere and will bring with it a set of additional administrative and legal challenges which should be avoided. Consequently, while DFA shares concerns with the proponents of Proposal 8, there are numerous problems with the proposal which counsel against its adoption as the solution for the problems which underlie this hearing.

The most obvious deficiency in Proposal 8 is that it would not address the issue of pooling non-California distant milk, such as the milk from Idaho or northern Wisconsin and Minnesota, which has no intention or practical ability to serve the fluid needs of the Order 32 market. Those milk supplies are being pooled for the sole purpose of drawing money out of the pool thereby reducing the pool proceeds to those producers who were and are committed to supply the needs of the market. The local producers continue to bear the costs and burdens of supplying the market but receive less compensation for it. Consequently, because Proposal 8 does not address all of the objectionable pooling revealed in this hearing record, it is an inadequate and insufficient answer to those problems.

There are a number of additional reasons why the Secretary should be cautious in adopting Proposal 8, in this or other hearings, and considering it a sufficient answer to the



pooling-without-performing issues:

**State regulations can and will change.** While the proposal as stated may apply as intended with respect to the existing California state regulations, those regulations could change, as witnesses have acknowledged. Any changes could require reconsideration or re-application of the proposal. Furthermore, defining milk with qualification on the basis of state regulations fundamentally cedes to state authorities what should be a federal issue, defining the qualifications for federal order pooling.

**An illegal trade barrier is erected.** The operation of Proposal 8 quite likely violates Section 8c(5)(G) of the AMAA, 7 U.S.C. Section 608c(5)(G), which prohibits the erection of trade barriers to any region or state in the federal order markets. Proposal 8 would create just such a barrier by operating to disqualify, regardless of performance, any milk from a state which regulated that milk in a certain fashion. In other words, if Proposal 8 was adopted, producers who supplied a fluid plant in the state of California, which plant became pooled in Order 32 by virtue of route disposition, would nevertheless be prohibited from sharing in the federal order pool of Class I revenues. It is very unlikely that this provision could survive legal scrutiny under the Act. If the imposition of compensatory payments upon milk moving from outside the marketing area, equal to a portion of the difference in class prices created an illegal trade barrier under Sani-Dairy v. Yeutter, 782 F.Supp.1060 (W.D.Pa.1991), and Lehigh Valley Cooperative Farmers v. United States, 370 U.S. 76 (1962), then a regulation which bars participation in the pool entirely from a region must be prohibited by the AMAA, 7 U.S.C. § 608c(5)(G).

Counsel for the upper midwest cooperatives has contended that Proposal 7 is unlawful in three (3) respects: (1) that it is an unlawful nearby differential under Zuber v. Allen, 396 U.S.

168 (1968); (2) that it unlawfully conditions pooling upon utilization, in conflict with Blair v. Freeman, 370 F.2d 229 (D.C.Cir. 1966); and (3) that it creates an impermissible trade barrier invalid under Section 8c(5)(g) of the AMAA. None of these contentions is valid. First, the Zuber case found unlawful the payment of special bonuses known as “nearby differentials” to all farmers whose farms were located in specific areas near to the cities in the Boston Order. It is self evident that there are no such similar payments being proposed here. However, what the upper midwest group overlooks is that after the nearby differentials were stripped from the Boston Order, what was left was exactly the system of plant point pricing which exists in Order 30 today and to which the upper midwest group objects.<sup>13</sup> The contention that there is an impermissible price differential created on the basis of use classification because producers are required to deliver milk to distributing plants is likewise without a legal basis. The Blair v. Freeman case which the upper midwest cites was addressing the same type of nearby differential payment which the Supreme Court ruled invalid in Zuber. The prior Court noted that the payments appeared to be premised upon higher fluid utilization, which may not be permissible in a marketwide pool. However, there is nothing in that decision, or anywhere else in the history of AMAA jurisprudence, which suggests that performance requirements for serving the fluid market are impermissible. Performance requirements are in fact all that is at issue here, not any type of payment differential, and without performance requirements, the marketwide pool would be dysfunctional. None of the upper midwest group’s legal theories is persuasive.

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<sup>13</sup> Any argument that in essence a nearby differential is created is based on the fact that the more distant producers have a lower net return after their deliveries to the pool plant than the producers whose farms are closer to the pool plant. In a plant point pricing system the producer has the cost of moving his milk from farm to market; that is what any “nearby differential” complaints are about and that system certainly does not violate the act.

In summary, Proposal 8 will not address the full extent of the problems which the record identifies exist with respect to the pooling of milk in Order 32. Moreover, it will bring with it a set of problems of its own which the Secretary will do well to avoid. Proposal 7 is the best solution to establishing reasonable performance-based requirements for the pooling of distant milk on Order 32.

VI. **THIS DECISION SHOULD BE RENDERED ON AN EMERGENCY**  
**BASIS, TIMED IN CONJUNCTION WITH THE HEARINGS ON ORDERS 30**  
**AND 33**

These cooperatives support the omission of a recommended decision from this hearing. The issues are important and urgent to the dairy farmers serving the order. Furthermore, by the spring months, the order will be in the “free ride” period for supply plants and a yet-steeper decline in the blend price will likely occur with the free association of huge quantities of out-of-area milk. Thus, prompt relief on the pooling issues is appropriate.

However, we remain concerned that the timing of implementation of the decision be done with consideration for the implementation of decisions on the hearings for Orders 30 and 33 so that the common pooling issues and concerns not be pushed from one order to the other solely by virtue of the administrative process. The California milk is a particular problem in this respect. If order 30 is amended in a way which will eliminate the pooling of California milk on that order substantially before this order is amended, the one-day-for-life touch base provisions in this order will allow those huge volumes of milk to be “economically” pooled on this order for some additional months. This result should be avoided with the implementation of decisions on these issues being coordinated.

## **XII. CONCLUSION**

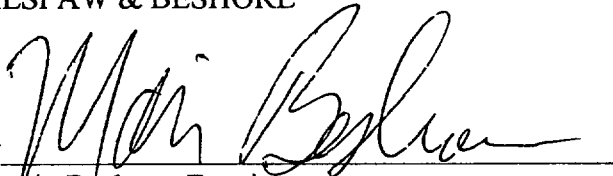
DFA, Swiss Valley and Prairie Farms respectfully request that the Department adopt the amendments to Order 32 which will restore it to a performance-oriented pooling system in accordance with the principles for federal order markets enunciated in the Final Rule.

In addition, the partial payment rate to producers should be amended to restore it to a rate which is more nearly the pre-reform payment rate.

RESPECTFULLY SUBMITTED,

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